A-LEVEL

# Economics

7136/1 - Paper 1 - Markets and Market Failure

Mark scheme

7136

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Version/Stage: 1.0 Final

Mark schemes are prepared by the Lead Assessment Writer and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation events which all associates participate in and is the scheme which was used by them in this examination. The standardisation process ensures that the mark scheme covers the students' responses to questions and that every associate understands and applies it in the same correct way. As preparation for standardisation each associate analyses a number of students' scripts. Alternative answers not already covered by the mark scheme are discussed and legislated for. If, after the standardisation process, associates encounter unusual answers which have not been raised they are required to refer these to the Lead Assessment Writer.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of students' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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# Level of response marking instructions

Level of response mark schemes are broken down into levels, each of which has a descriptor. The descriptor for the level shows the average performance for the level. There are marks in each level.

Before you apply the mark scheme to a student's answer read through the answer and annotate it (as instructed) to show the qualities that are being looked for. You can then apply the mark scheme.

## Step 1 Determine a level

Start at the lowest level of the mark scheme and use it as a ladder to see whether the answer meets the descriptor for that level. The descriptor for the level indicates the different qualities that might be seen in the student's answer for that level. If it meets the lowest level then go to the next one and decide if it meets this level, and so on, until you have a match between the level descriptor and the answer. With practice and familiarity you will find that for better answers you will be able to quickly skip through the lower levels of the mark scheme.

When assigning a level you should look at the overall quality of the answer and not look to pick holes in small and specific parts of the answer where the student has not performed quite as well as the rest. If the answer covers different aspects of different levels of the mark scheme you should use a best fit approach for defining the level and then use the variability of the response to help decide the mark within the level, ie if the response is predominantly level 3 with a small amount of level 4 material it would be placed in level 3 but be awarded a mark near the top of the level because of the level 4 content.

## Step 2 Determine a mark

Once you have assigned a level you need to decide on the mark. The descriptors on how to allocate marks can help with this. The exemplar materials used during standardisation will help. There will be an answer in the standardising materials which will correspond with each level of the mark scheme. This answer will have been awarded a mark by the Lead Examiner. You can compare the student's answer with the example to determine if it is the same standard, better or worse than the example. You can then use this to allocate a mark for the answer based on the Lead Examiner's mark on the example.

You may well need to read back through the answer as you apply the mark scheme to clarify points and assure yourself that the level and the mark are appropriate.

Indicative content in the mark scheme is provided as a guide for examiners. It is not intended to be exhaustive and you must credit other valid points. Students do not have to cover all of the points mentioned in the Indicative content to reach the highest level of the mark scheme.

An answer which contains nothing of relevance to the question must be awarded no marks.

## Key to annotations:

| Annotation | Meaning/Use |
|---|---|
| ? | Unclear |
| AN | Analysis |
| APP | Application |
| BOD | Benefit of the doubt |
| X | Cross/Incorrect |
| EVAL | Evaluation |
| Highlight | Highlight |
| On Page Comment | On Page Comment |
| IR | Irrelevant |
| KU | Knowledge and Understanding |
| NAQ | Not answered the question |
| REP-BIG | Repeat |
| SEEN | Reviewed but no marks awarded |
| Tick | Correct point |

Below is the levels of response marking grid to be used when marking any 25 mark question.

| Level of response | Response | Max 25 marks |
|---|---|---|
| **5** | **Sound, focused analysis and well-supported evaluation that:**<br>• is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors<br>• includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response<br>• includes well-focused analysis with clear, logical chains of reasoning<br>• includes supported evaluation throughout the response and in a final conclusion. | **21–25 marks** |
| **4** | **Sound, focused analysis and some supported evaluation that:**<br>• is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors<br>• includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response<br>• includes some well-focused analysis with clear, logical chains of reasoning<br>• includes some reasonable, supported evaluation. | **16–20 marks** |
| **3** | **Some reasonable analysis but generally unsupported evaluation that:**<br>• focuses on issues that are relevant to the question, showing satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present<br>• includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response<br>• includes some reasonable analysis but which might not be adequately developed or becomes confused in places<br>• includes fairly superficial evaluation; there is likely to be some attempt to make relevant judgements but these aren't well-supported by arguments and/or data. | **11–15 marks** |
| **2** | **A fairly weak response with some understanding that:**<br>• includes some limited knowledge and understanding of economic terminology, concepts and principles is shown but some errors are likely<br>• includes some limited application of relevant economic principles to the given context and/or data to the question<br>• includes some limited analysis but it may lack focus and/or become confused<br>• includes some evaluation which is weak and unsupported. | **6–10 marks** |
| **1** | **A very weak response that:**<br>• includes little relevant knowledge and understanding of economic terminology, concepts and principles<br>• includes application to the given context which is, at best, very weak<br>• includes attempted analysis which is weak and unsupported. | **1–5 marks** |

## Section A

**Context 1** **Total for this context: 40 marks**

**0 1** Using **Extract A**, calculate the ratio of customers gained to customers lost by Nationwide. Give your answer correct to **one** decimal place.

**[2 marks]**

Calculation:
153000/43000 = 3.558

Correct answer is 3.6:1, also allow 3.5:1, 3.7:1; or 1:0.3

| **Response** | **Max 2 marks** |
|---|---|
| For the correct answer to one decimal place | **2 marks** |
| For the correct answer but not expressed as a ratio and/or not to one decimal place and/or not reduced to its simplest form | **1 mark** |
| For the answer expressed as a ratio of customers lost to customers gained, ie 0.3:1; or 1:3.6, also allow 1:3.5, 1:3.7 | **1 mark** |

**0 2** Explain how the data in **Extract A** show that the market power of the Big Four banks is weakening against competition from smaller rivals.

**[4 marks]**

| **Response** | **Max 4 marks** |
|---|---|
| • includes evidence that shows that the market power of the Big Four is weakening against competition from smaller rivals<br>• clearly explains how this data is evidence of weakening Big Four market power. | **4 marks** |
| • includes evidence that shows that the market power of the Big Four is weakening against competition from smaller rivals<br>• unclear explanation of how this data is evidence of weakening Big Four market power. | **3 marks** |
| • includes some limited evidence that shows that the market power of the Big Four is weakening against competition from smaller rivals<br>• limited explanation of how this data is evidence of weakening Big Four market power. | **2 marks** |
| • includes evidence that does not clearly show that the market power of the Big Four is weakening against competition from smaller rivals<br>• no explanation of how this data is evidence of weakening Big Four market power. | **1 mark** |

**Relevant issues include:**

- explanation of the concept of market power
- factors that determine market power, eg market share, degree of competition
- the Big Four as a group have gained approximately 485 000 but lost 670 000, a net loss of 185 000
- Barclays and RBS Natwest have been the biggest net losers (100 000 and 115 000 respectively)
- Santander, TSB, Nationwide and others have gained approximately 435 000 but lost 253 000, a net gain of 182 000
- Nationwide and Santander are the biggest net gainers (110 000 and 83 000 respectively)
- Lloyds goes against the trend of the Big Four, by gaining customers.

**Note**: Please allow a margin of +/- 5000 customers per bank

**0 3** **Extract C** (lines 10–11) states that 'There is ample opportunity for new players to enter the sector.'

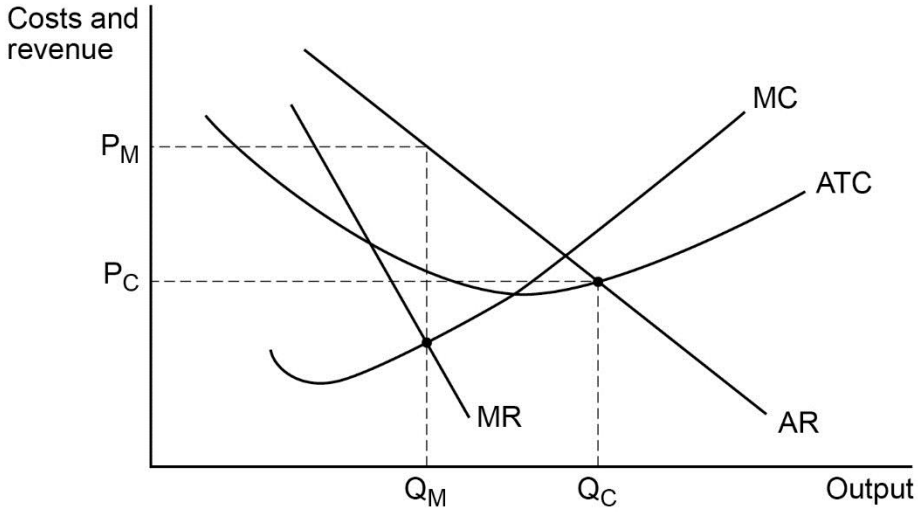
With the help of a diagram, explain how the lowering of barriers to entry in the banking market might lead to lower prices and a situation in which banks make normal profit.

**[9 marks]**

| Level of response | Response | Max 9 marks |
|---|---|---|
| **3** | • is well organised and develops one or more of the key issues that are relevant to the question<br>• shows sound knowledge and understanding of relevant economic terminology, concepts and principles<br>• includes good application of relevant economic principles and/or good use of data to support the response<br>• includes well-focused analysis with a clear, logical chain of reasoning<br>• includes a relevant diagram that will, at the top of this level, be accurate and used appropriately. | **7 - 9 marks** |
| **2** | • includes one or more issues that are relevant to the question<br>• shows reasonable knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present<br>• includes reasonable application of relevant economic principles and/or data to the question<br>• includes some reasonable analysis but it might not be adequately developed and may be confused in places<br>• may include a relevant diagram. | **4 - 6 marks** |
| **1** | • is very brief and/or lacks coherence<br>• shows some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely<br>• demonstrates very limited ability to apply relevant economic principles and/or data to the question<br>• may include some very limited analysis but the analysis lacks focus and/or becomes confused<br>• may include a relevant diagram but the diagram is not used and/or is inaccurate in some respects. | **1 - 3 marks** |

**Suggested diagram:**

- a monopoly diagram is expected, showing a firm profit maximising initially, but subsequently reducing prices closer to (or at) normal profit. A monopolist facing potential entrants in a contestable market would fear entry and reduce price from $P_m$ to $P_c$, with profits falling to just normal profits




- other reasonable diagrams are acceptable, eg monopolistic competition with the AR/MR shifting left because of entry

**Relevant issues include:**

- explanation of contestability and barriers to entry in the banking industry
- explanation of "new players", including examples, such as Metro Bank
- why increased competition usually reduces prices and profits
- analysis of how supernormal profits can be driven towards zero by the presence (or even mere threat) of new entrants
- reference to increasing innovation and focus on customer service of new entrants
- explanation of how improving the customer switching service may reduce customer inertia
- reference to falling revenue per customer.

**0 4** **Extract B** (lines 4–5) states that 'banks do not feel enough pressure to compete on price or quality, leading some to call for the Big Four to be split into a number of smaller banks.'

Use the extracts and your knowledge of economics to assess the view that the government should intervene further in the banking sector to promote greater competition.

**[25 marks]**

**Areas for discussion include:**

- explanation of competition and the range of government policies to foster competition
- discussion of the nature of the UK banking sector and the historic dominance of Lloyds, Barclays, RBS Natwest and HSBC
- awareness of recent changes to the market structure, eg
    - 2008 financial crisis – Northern Rock, Bradford & Bingley bankruptcies
    - Lloyds-HBOS merger, TSB demerger
- innovation in the banking sector, resulting in a move away from FIIC accounts towards packaged accounts and cashback
- Big Four problems over unwieldy and costly IT infrastructure, diseconomies of scale and scope
- barriers to entry in the banking sector, including
    - legal/ regulatory
    - physical, eg branch network
    - financial, eg start-up capital required
    - customer inertia (link to behavioural economics)
- comparison with other utilities' contestability
- discussion of possible policies, including
    - breaking up large banks (eg demerger of TSB and Lloyds, and attempted sale by RBS of Williams and Glyn)
    - price regulation
    - improving information in the market, eg price comparison websites and Customer Switching Service
    - nudge/ behavioural policies (as per CMA Review)
- recent rise in new entrants and connection to the rise of internet banking
- benefits of competition
- benefits of concentration, eg economies of scale, high MES, high profits facilitating innovation
- the impact of market forces, creative destruction and new technology in the banking sector
- are the banks exploiting consumers, including possible collusion?
- the role of the Bank of England, the PRA and the FPC
- market failure arguments
- government failure arguments.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

**Use the levels mark scheme on page 5 to award candidates marks for this question.**

**Context 2** **Total for this context: 40 marks**

**0 5** Using **Extract D**, calculate the number of transportation and storage jobs at high risk of automation, as a percentage of those who are at high risk across all industries. Give your answer to **two** decimal places.

**[2 marks]**

Calculation: 0.95/10.4 x 100 = 9.1346%

Correct answer is 9.13%

| **Response** | **Max 2 marks** |
|---|---|
| For the correct answer with the % sign and to two decimal places | **2 marks** |
| For the correct answer but without the % sign and/or not to two decimal places | **1 mark** |
| For rounding the wrong way i.e. 9.14% | **1 mark** |

**0 6** Explain how the data in **Extract D** show that workers employed in routine, repetitive, work are at greater risk from automation.

**[4 marks]**

| **Response** | **Max 4 marks** |
|---|---|
| • includes evidence that shows that workers in routine, repetitive work are at greater risk of automation than those whose work involves more variety<br>• clearly explains how this data is evidence that workers in routine, repetitive work are at greater risk of automation | **4 marks** |
| • includes evidence that shows that workers in routine, repetitive work are at greater risk of automation than those whose work involves more variety<br>• unclear explanation of how this data is evidence that workers in routine, repetitive work are at greater risk of automation | **3 marks** |
| • includes some limited evidence that shows that workers in routine, repetitive work are at greater risk of automation than those whose work involves more variety<br>• limited explanation of how this data is evidence that workers in routine, repetitive work are at greater risk of automation | **2 marks** |
| • includes evidence that does not clearly show that workers in routine, repetitive work are at greater risk of automation than those whose work involves more variety<br>• no explanation of how this data is evidence that workers in routine, repetitive work are at greater risk of automation. | **1 marks** |

**Relevant issues include:**

- explanation of automation
- why workers in routine, repetitive work are at greater risk from automation
- how work in some sectors involves more varied, non-routine, skilled tasks than others
- wholesale and retail is the sector with the largest at-risk workforce (2.25 million)
- water, sewage and waste (62.6%), transport and storage (56.4%) and manufacturing (46.4%) are the sectors at highest risk if automation. All these sectors have a high proportion of workers employed in repetitive routine work
- the sectors at lowest risk include education (8.5%) and human health (17.0%), and professional, scientific and technical (25.6%). All these sectors have workers employed in very varied tasks.

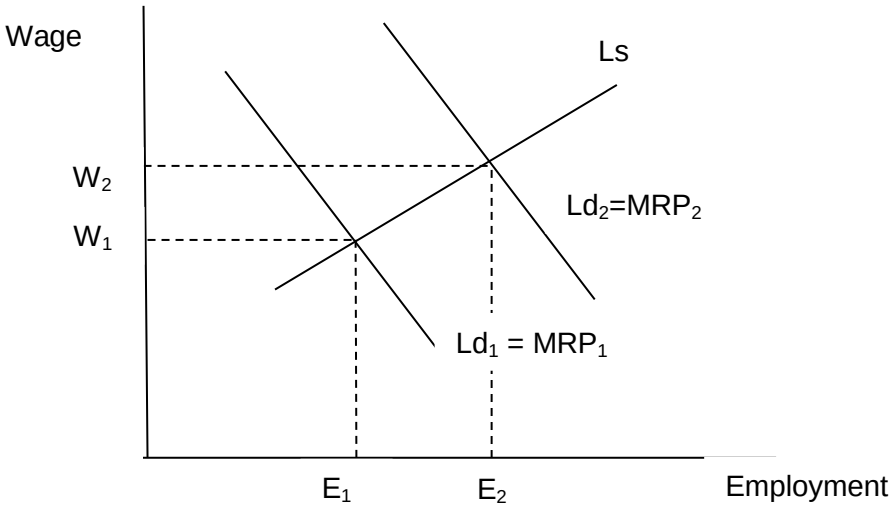
**0 7** **Extract E** (lines 4–5) claims that workers in the 18th century saw wages rise in line with productivity.

With the help of a diagram, explain how advances in modern technology are likely to lead to rising wages in some industries.

**[9 marks]**

| **Level of response** | **Response** | **Max 9 marks** |
|---|---|---|
| **3** | • is well organised and develops one or more of the key issues that are relevant to the question<br>• shows sound knowledge and understanding of relevant economic terminology, concepts and principles<br>• includes good application of relevant economic principles and/or good use of data to support the response<br>• includes well-focused analysis with a clear, logical chain of reasoning<br>• includes a relevant diagram that will, at the top of this level, be accurate and used appropriately. | **7-9 marks** |
| **2** | • includes one or more issues that are relevant to the question<br>• shows reasonable knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present.<br>• includes reasonable application of relevant economic principles and/or data to the question.<br>• includes some reasonable analysis but it might not be adequately developed and may be confused in places<br>• may include a relevant diagram. | **4-6 marks** |
| **1** | • is very brief and/or lacks coherence<br>• shows some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely<br>• demonstrates very limited ability to apply relevant economic principles and/or data to the question<br>• may include some very limited analysis but the analysis lacks focus and/or becomes confused<br>• may include a relevant diagram but the diagram is not used and/or is inaccurate in some respects. | **1-3 marks** |

A labour market diagram is expected, showing the MRP curve shifting right, as technological progress increases labour productivity.




- other reasonable diagrams are acceptable, eg cost curve diagrams

**Relevant issues include:**

- how automation and technological progress boost labour productivity within industries and markets
- connection between MPP, MRP and the demand for labour
- why labour productivity is likely to affect the wage rate
- how machines create a derived demand for workers who can maintain the machines, and the impact of this on jobs and wages
- how advances in technology can lead to new products and / or lower prices creating derived demand for workers to produce the good and therefore higher wages
- how advances in technology can lead to lower costs and an increase in profits which may lead to an increase in wages.

**0 8** **Extract E** (lines 14–16) states that 'The market economy is not going to create the jobs by itself for those workers who are most affected by the change'.

**Extract F** (lines 4–5) states that 'taxing productivity-enhancing tools like robots or machines makes no economic sense'.

Use the extracts and your own knowledge of economics to evaluate whether governments should allow markets to respond freely to the opportunities and challenges presented by technological progress, without any state intervention.

**[25 marks]**

**Areas for discussion include:**

- what is meant by technological progress
- the historical impact of technological progress and how it has affected labour markets
- current issues around technological unemployment (eg self-service supermarket checkouts, driverless trucks, self-service ticket machines)
- the likely impact on jobs and wages
- concerns about the impact of technological progress on inequality and poverty, linked to regional and sectoral differences (making use of Extract D)
- labour market imperfections which make it difficult for unemployed worker to transfer into other jobs or locations
- how automation is now threatening well-paid, high-status jobs such as surgeons and accountants, not only manufacturing or retail work, and that the determining factor for automation risk is whether the tasks are routine or varied
- the optimists' argument that robots will only be used where profit can be made, and this requires a customer base who need to have a source of income (most likely to come from wages)
- the benefits of allowing the price mechanism to function
- analysis and assessment of the consequences of technological progress as a result of dynamic efficiency on costs, output, quality in product markets
- analysis and assessment of: the UBI proposal, a robot tax, retraining programmes, job creation programmes or any other appropriate form of intervention
- discussion of possible government failure when designing policies in such a fast-moving area
- the case against intervention, to allow market forces to redistribute labour and other factors of production to where they are demanded
- the view that the basic economic problem of scarcity is unlikely to be solved and hence new jobs will always be created to replace those that are lost
- evaluation of how much automation is actually a problem that needs to be addressed
- market failure arguments
- government failure arguments.

**Use the levels mark scheme on page 5 to award candidates marks for this question.**

## Section B

Below is the levels of response marking grid which should be used to mark the 15 mark questions

| Level of response | Response | Max 15 marks |
|---|---|---|
| **3** | **A good response provides an answer that:**<br>• is well organised and develops a selection of the key issues that are relevant to the question<br>• shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors<br>• includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response<br>• includes well-focused analysis with clear, logical chains of reasoning. | **11–15 marks** |
| **2** | **A reasonable response provides an answer that:**<br>• focuses on issues that are relevant to the question<br>• shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present<br>• includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response<br>• includes some reasonable analysis but which might not be adequately developed or becomes confused in places. | **6–10 marks** |
| **1** | **A weak response provides an answer that:**<br>• has identified one or more relevant issues<br>• has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely<br>• has very limited application of relevant economic principles to the given context and/or data to the question<br>• might have some limited analysis but it may lack focus and/or become confused. | **1–5 marks** |

## Section B

**Essay 1**

**Total for this essay: 40 marks**

**0 9** Explain why the use of petrol and diesel cars may be a source of market failure.

**[15 marks]**

**Areas for discussion include:**

- definition of market failure
- distinction between MSB and MPB (allow MSC and MPC)
- explanation of why MPB is greater than MSB
- analysis of the negative consumption (allow production) externalities produced by driving petrol and diesel cars
    - air pollution
    - noise pollution
    - congestion
    - accidents
- why the existence of negative externalities leads to over-production and consumption
- discussion of current government interventions such as licences, speed limits, age restrictions, congestion charge
- information asymmetry problems, for example the fact that diesel cars used to be thought of as cleaner than petrol cars.

  The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

**Use the levels mark scheme on page 16 to award candidates marks for this question.**

**1 0** Assess the view that regulation is a better policy for dealing with the problem of air pollution than the allocation of property rights or taxation.

**[25 marks]**

**Areas for discussion include:**

- analysis of the main sources of air pollution (road vehicles, ships, factories, energy production)
- analysis of the main impacts of air pollution (localised health problems, smog, acid rain, global warming)
- the impact that existing policies have had, eg air passenger duty, fuel excise duty, regulations surrounding emissions (NB Volkswagen scandal), price controls
- explanation of regulation
- the benefits of regulation (simple, easy to change, easier to enforce)
- the costs of regulation (blunt and inefficient tools, create rent-seeking behaviour, unresponsive to changing markets)
- explanation of property rights and how a clear allocation of property rights might help,
- the limitations of property right allocation as an effective policy
    - how the initial allocation of property rights can be extremely problematic
    - how difficult it can be to identify when a right is being breached. For example, if an individual has a right to clean air, how is "clean air" to be defined?
- the success or otherwise of tradable permit systems such as the EU Emission Trading Scheme and the Californian trading system
- explanation of environmental taxation and how it might be applied in this context
- the benefits and costs of taxation
- the international nature of the problem, meaning that interventions taken by individual countries can address localised problems such as smog, but that problems such as global warming require coordinated global action
- examples of successful/unsuccessful regulatory interventions
- whether improved information can be an effective antidote to polluting behaviour
- government failure arguments.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

**Use the levels mark scheme on page 5 to award candidates marks for this question.**

**Essay 2**

**Total for this essay 40 marks**

**1 1** Explain how the Lorenz curve and Gini coefficient may be used to illustrate increasing income inequality in a country.

**[15 marks]**

**Areas for discussion include:**

- a clear diagram of the Lorenz curve correctly labelled
- explanation of how perfect equality and perfect inequality are represented
- explanation of how the shape of the curve relates to the cumulative proportions of income and population
- the connection between the Lorenz curve and the Gini coefficient
- how the Lorenz curve and Gini coefficient could be used to show increasing inequality. This is most likely to be done by using the diagram to show 2 Lorenz curves on the same axes.

  The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

**Use the levels mark scheme on page 16 to award candidates marks for this question.**

**1 2** Assess the view that, in the UK, the consequences of wealth inequality are more damaging than the consequences of income inequality.

**[25 marks]**

**Areas for discussion include:**

- explanation of the distinction between wealth and income
- the sources of wealth (inheritance, gifts, accumulated earned income, etc.)
- the sources of income (wages, rent, interest, dividends, etc.)
- the trends in wealth and income inequality in the UK
- how useful it is to consider inequality as a snapshot in time rather than looking at inequality across entire lifetimes (eg students are very likely to have low income, but likely to have high social mobility)
- the consequences of wealth inequality
    - unequal distribution of property, causing some to live in low-quality homes, or having to frequently move house
    - asset bubbles and property speculation
    - the hindrance of social mobility via the wealthy affording better education, health, cultural goods
    - impact on poverty, including child poverty and pensioner poverty
    - impact on income inequality, as wealth creates income via interest, rent and dividends
    - the argument that only the wealthy can afford to take big risks as entrepreneurs, so have access to high risk/ high reward opportunities
    - envy and jealousy leading to social problems
    - intergenerational problems arising from (mainly) property inequality, the changing nature of university funding
- the consequences of income inequality
    - a sense of unfairness, especially if associated with discrimination or gender/race-based pay gaps
    - impact on aggregate demand
    - impact on economic growth and performance
    - impact on social indicators, such as crime, education, physical health, mental health
    - several of the factors listed above under wealth inequality
- analysis of policies currently used by the UK government (eg inheritance tax, income tax, capital gains tax, national insurance) and whether these are progressive, proportional or regressive
- analysis of other possible policies such as restrictions on second homes, 'mansion tax', forcing independent schools to charge VAT
- analysis of policies to prevent inequality between the top 1%/0.1% and the rest of the population
- the tendency of markets to increase rather than decrease inequality
- the argument that wealth and income inequality are not serious issues because of the trickle-down effect
- the argument that some degree of income and wealth inequality is inevitable in a market economy and perhaps desirable, to provide incentives and allocate resources effectively
- the argument that neither is worse than the other, that they are equally damaging.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

**Use the levels mark scheme on page 5 to award candidates marks for this question.**

**Essay 3**

**Total for this essay: 40 marks**

**1 3** Explain the role of profit in a market economy.

**[15 marks]**

**Areas for discussion include:**

- definition of profit, normal profit, supernormal profit, firm
- the need for firms to make at least normal profit to remain in their present use, including short run vs long run requirements
- firms use of supernormal profits as a necessary inducement for risk-taking, source of investment funds, as a reward to the owners of the firm, as an indicator of the firm's health as a going concern and as a source of working capital
- the role of profit in the wider economy
    - as the incentive to establish and run any enterprise in a free market economy
    - investment in technology and innovation, eg public benefits of new drugs
    - as a source of income, especially for pensioners
    - as a signalling device for high growth industries, to promote the efficient allocation of resources within an economy
    - as a source of tax revenue.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

**Use the levels mark scheme on page 16 to award candidates marks for this question.**

**1 4** Evaluate the view that a firm making low profits must be inefficiently managed.

**[25 marks]**

**Areas for discussion include:**

- explanation of 'inefficiently managed'
- distinction between firms operating in monopoly markets from those in competitive markets, and how profits may indicate monopoly power rather than good management
- discussion of objectives of firms, including the divorce of ownership from control, sales maximisation, revenue maximisation and other objectives
- in a profit-maximising monopoly firm, low profit may indicate the firm is badly run, perhaps due to x-inefficiency or diseconomies of scale
- alternatively, the firm could be attempting to prioritise scale, rather than profits at least in the short-run
- short-run vs long-run objectives of firms, and how these are influenced by the ownership of the firm, eg family firm vs listed firm vs nationalised firm
- in highly competitive industries, firms must be well run if they are to survive, but they are unlikely to be making any supernormal profits in the long run
- some industries are inherently less profitable, because of high costs, low degree of risk or low demand
- high levels of market contestability may result in low profits
- sometimes unexpected events can affect profitability (eg changing trends, environmental disasters, terrorism) which affect profits beyond the control of the firm's management)
- examples of firms which support the question's claim, and those which do not
- the impact of government intervention on profitability
- the practice by some firms of disguising profitability to avoid paying corporation tax.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

**Use the levels mark scheme on page 5 to award candidates marks for this question.**